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# Economic Conditions
# Governmental Finance
# United States Securities

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## General Business Conditions

THIS Letter goes to press at a time when early settlements of the major strikes which are now disrupting production are widely expected, but when the reports of progress are still indefinite and there is still little basis for firm comment. On the one hand are the wage agreements made by Ford, Chrysler and the Radio Corporation of America, among others, which may set the pattern for other agreements; renewal of negotiations in other strikes; the return to work of the packing house workers following government seizure of the plants; and the agreement to arbitrate the claims of eighteen unions of railway workers. All these are signs of a clearing atmosphere.

On the other hand, the steel strike, which threatens a precipitous decline in industrial production if it lasts much longer, presents peculiarly difficult problems. The industry has a case with the Office of Price Administration for price increases based on pre-strike costs, since much steel even then was being produced at a loss. Thus part of any price advance now granted must be allocated to cover the costs prevailing before the strike, and only part will be available to support wage increases. This does not seem to be understood in all discussions of the strike. Also the position of the fabricators of steel is to be considered. They face higher prices for the steel they use, and they cannot escape the round of wage increases. Thus they have a double interest in the terms of the steel settlement. The consumers who buy the final products have an equal interest.

Despite the encouraging signs, it may be over-optimistic to assume that settlement of the major strikes, on terms accepted by large companies of superior efficiency and financial strength, will set a pattern that all companies can follow and therefore reestablish industrial peace and production promptly. With the enormous demand for goods, the smaller companies doubtless would not bargain to the last cent if their prices were free. But prices are not free and relief from squeezes is problematical. How far the smaller companies can follow the pattern set by the larger, whether their workers will be satisfied with what they can pay, and how much strife may develop, all remain to be seen.

### A World Emergency

Allowing for the necessary qualifications, however, it is the general view that the picture is brightening, and the natural reaction is one of relief. Everyone can join in this feeling. The country has never been nearer a general strike than in the middle of the past month, with the steel mills, packing houses, electrical manufacturing plants and the huge General Motors factories closed, with telegraphic communication hampered, with a host of minor strikes under way and with other stoppages threatened, even on the railroads. Nor has there ever been a time, in peace, when production was more urgently needed or strikes more costly.

The world is in the midst of a great emergency. It is in turmoil and distress, and facing want and disorder, in large part because of scarcity of goods that are needed both in every day life and for reconstruction. In this country every dictate of humanity, statesmanship and common sense called on us to lift production to the maximum early and rapidly; all our money gifts and loans become a futile gesture unless we produce goods to be bought with the money. We also had our own interest to serve,— to provide employment for returning veterans and displaced war workers, to supply the markets and satisfy demands, to combat inflation, and to resume our historical progress in raising living standards.

Yet weeks and months have been lost. Not only has the current output of goods been reduced by strikes, but reconversion has been set back. The inflation danger has been intensified both by the loss of production and by the wage and price increases. It will hardly have escaped attention that, even with an immense number of people on strike and others

out of work because strikes have stopped the flow of parts and materials, retail trade and other consumer expenditures nevertheless have held at record-breaking figures. Department store sales in the four weeks ended January 26, in dollars, were 11 per cent above a year ago.

In these sustained expenditures, in a time of increasing idleness and lessened production, is seen the working of inflation. People who are not producing are nevertheless presenting financial claims for a part of existing supplies. These claims — money or war bonds "saved" during the war, or money provided by unemployment compensation, mustering-out pay or other payments supplied in last analysis by deficit financing and credit expansion — augment those of the people who are producing and earning. But there is no commensurate addition to the supply of goods. Hence the pressure on prices. The scarcities intensify the eagerness to buy, and demand piles up.

### Cost to Workers

The cost of a strike to the workers is effectively described in the January issue of the official Monthly Survey published by the American Federation of Labor. It points out that if workers earning $1.00 an hour are offered an increase of 12c by their employer, but go on strike and stay out for eight weeks in order to obtain an increase of 18c, they will lose $358 in pay (eight weeks of 40 hours at $1.12); and that the 6c increase obtained by the strike will not repay this loss for nearly three years. If the strike obtains only 3c more than the employer offers, nearly six years will be required to make up for the loss.

In ordinary times these calculations might be received with the reservation that the assumed loss of pay would become a real loss only in case the loss of time proved irrecoverable and could not be made up by more days or more weeks of work later. Under present conditions, however, the pertinence of the A.F of L.'s remarks can hardly be questioned, for there is need for everything that can be produced for an indefinite time, and the foreseeable future will hold little room to make up time that is lost now.

Moreover, the A.F. of L. publication says: "If the extra 3c or 6c breaks a price ceiling workers may take losses they can never regain. For every family with savings or life insurance, each dollar will be reduced to 95c or 92c in buying power." This is a loss which affects everyone.

### Effects on Prices

Feelings of gratification over progress toward settling the strikes need not exclude objective consideration of the terms of settlement, or an estimation of where the economic situation stands as a result. The range of wage increases agreed to by Ford, Chrysler, Radio Corporation, and others is about 15 to 18 per cent. These are large increases. If the pattern is to be followed in every controversy, and wages adjust to this level where they have not already done so, price increases will follow in many cases, the O.P.A. having no choice but to acquiesce. Government and labor agree with the steel makers that any increase in steel wages must compel a price increase. In automobiles part of the wage raise (the part necessary to lift average straight time hourly earnings to 33 per cent above January, 1941, equalling the rise in the cost of living) entitles the employers to appeal to the O.P.A. for higher prices.

Wage increases can be absorbed without raising prices excessively or squeezing profits unbearably if there is a proportionate increase in output per worker and if capacity operations can be maintained. Light was thrown on current output per worker by a statement of Henry Ford, 2nd, president of the Ford Motor Co., in an address in Detroit January 9. Citing figures for certain operations, Mr. Ford said that on the whole productivity per worker in the company's plants declined more than 34 per cent during the war period. The automobile industry has been one of the worst sufferers, but evidence of substantial declines in other industries is available. Mr. Ford has agreed to an 18c wage increase nevertheless, because as he said on another occasion, "we have faith in the future of America." However, he refers to "the risk we have taken."

The country should be aware that in accepting general wage increases of 15 to 18 per cent the industries which are now suffering from low man-hour output are gambling on improvement. They are hoping for a rise in productivity, anticipating it, and making commitments based on the anticipation. In the nature of things labor cannot make as definite and unequivocal commitments on output, but management has a right to expect responsible cooperation and performance by workers, removal of "feather-bedding" and similar restrictive practices, and penalties for unauthorized strikes, slowdowns, excessive absenteeism, and other labor evils. For if this cooperation is not given the wage increases will prove insupportable. Moreover, it is appropriate to say now that the future improvement in man-hour output, which is expected and allowed for in the present wage increases, cannot properly be made the basis for further wage demands when it occurs.

Where the drop in efficiency has reached the proportion cited by Mr. Ford, room for vast improvement exists. In other industries, how-

ever, where reconversion has involved less drastic readjustments, there is less room for improvement and gains commensurate with these wage increases are hardly to be expected. If these industries have to accept 15 to 18 per cent wage increases the squeeze will be severe.

### The Question of Volume

Along with increased productivity as support for higher wages naturally goes the expectation of huge volume. Nearly all industries expect high volume when they can get the production, and are ready to take it into consideration in negotiating wage rates. The principle of basing wage rates on prophecies of capacity operation, however, raises another question, which because it relates to the long rather than the short run now receives little consideration. If wage rates are lifted to the most the producer can bear when he is driving every facility at its fullest capacity, what will the situation be when this condition changes? Dr. L. Albert Hahn has a thoughtful discussion of the subject in the Commercial & Financial Chronicle, December 27, 1945. Discussing the distortions of prices and wages which result from inflationary pressures, he says:

> Even where price rises are avoided the economy will prove increasingly vulnerable. Wages are under the permanent upward pressure. The ensuing wage increases—where they do not lead to unemployment—are bearable only because the huge turnover due to the enormous pent up demand cheapens and alleviates production and distribution. It is a very high strung system, in which the price-cost relationship remains tolerable only so long as everything works full blast and at high speed. As soon as the slightest slackening in demand will set in, many enterprises will have to shut down because of the losses they suffer. Exactly as at the onset of every depression, the boom will collapse through the losses that the marginal enterprises begin to undergo; only that, this time not the decline of prices, but the decline of turnover will be the initiating cause.

These words are worth pondering by everyone, and especially by labor leaders. Little attention is now being given to the effect of wage rates upon employment, for the opinion that the industries can sell everything they can turn out is so prevalent that few give thought to the possibility that labor may price itself out of the market. But if a condition of full employment is reached after the industries get going, how long will it last if the cost of union labor raised by monopolistic bargaining sets prices of goods at levels beyond the reach of unorganized workers, those living on fixed incomes and similar groups; and if capacity output therefore cannot be sold? A condition of general inflation and accumulation of wants can obscure a lack of balance in prices and costs for a time, but in the long run it must have its effect in falling sales, declining production and employment, deflation and depression.

A further question suggests itself. Will it then be said that private industry has failed to provide full employment and that the Government must intervene? Will the responsibility that excessive wage rates bear for the unemployment be ignored?

These questions inevitably present themselves as the wage increases go their rounds. For the short run all the doubts and difficulties may be absorbed in the rush of inflated demands, but in the long run the considerations outlined are the ones that will mark the difference between lasting prosperity, stability and order, and the "boom and bust" route. As Dr. Hahn brings out, the real danger of the situation is to be judged not solely by the price level, which is the layman's usual measure of inflation, but by the cost levels created in a time of feverish production and turnover.

### The Whole View

This view of the dangers is presented here not as a prophecy of "boom and bust," but to urge understanding of the situation as a whole. Many people form their opinions around one aspect of the wage question. Some think the decline in the take-home pay of war workers is the only important matter; to them the answer seems simple, namely, that wages should be raised "to maintain purchasing power." Others think it solely a question of ability to pay, — that manufacturers expect to make money, and that wages therefore should be raised.

The report of the fact-finding board in the General Motors case was based on precisely these two points. It made a forecast of the probable hours of work by the corporation in 1946 and calculated the percentage increase in straight time average hourly earnings necessary to produce, for the estimated working hours, a weekly take-home pay equal to the war figure. It joined with this an estimate of the corporation's ability to pay the required increase. This involved forecasts not only of hours of work but of output per man-hour, materials costs, sales volume, and earnings. What emerged from this forecasting process was an opinion that General Motors could pay the percentage increase required to maintain take-home pay in case hours of work were reduced from the war average of 45.6 to a little over 40. Recommendation of a 19½c an hour wage increase was made accordingly.

Forecasts are not facts. Whether they are reasonable expectations or not is solely for the General Motors Corporation, which must bear the risks, to judge. From the viewpoint of the public interest, the important matter is that the board confined itself to a narrow view of the question. This is not said in criticism, for the board was not charged with determining na-

tional wage policy, which is a function of the Government. Nevertheless, figures have gone into the record, they have influenced the terms of other negotiations and their influence will continue to spread. They will affect not only the General Motors settlement, but settlements that higher cost producers have to make. Yet they ignore the most important questions of all, namely, whether the increase in costs (and of course in prices, as compared with what prices could have been without the wage increases) will limit production and growth and lessen employment; and whether it will contribute to inflation and add to the "boom and bust" danger.

A whole view of the matter emphasizes these hazards. It also indicates the only way in which the inflationary effects of the wage increases can be absorbed. This is the way of increased efficiency and increased man-hour output. The optimistic view is that this increase will appear as the strikes end, war veterans eager to get ahead return to work, and the industries settle down. Encouragement and hope are to be found in the fact that discussions of productivity, of company security and penalties for wildcat strikes are part of many current labor negotiations; and that many of the unions are willing to give certain assurances and make provision for penalties.

**Two Important Labor Pronouncements**

From labor circles have come recently two important and encouraging pronouncements. We have already referred to the January issue of the Monthly Survey of the American Federation of Labor. This issue set forth for the guidance of members "four commandments of progressive collective bargaining." The following is a condensed description of these commandments taken from a Washington dispatch to the New York Sun:

> Under the heading "Good Faith and Square Dealing on Both Sides of the Conference Table," it admonished workers to "keep your contract. A broken contract is the mark of bad faith and irresponsibility."
>
> Under the heading "know your industry and know your company," it reminded workers: "Remember that your collective bargaining conference is the business of your union and your employer. The company does not want its information released to competitors. Don't injure your company's business."
>
> Commandment No. 3 reads: "Remember that three groups—workers, consumers and management—should share the wealth created by American industry. This is the American way forward to higher living standards. Industry's profits should bring (1) wage increases; (2) price reductions; (3) reward for management as an incentive to improve production. Also, reserves must be laid aside to buy the new machinery which will increase productivity and make further wage gains possible; and investors must receive enough return on their investment to bring your company adequate financing. You cannot expect all the profit to go into wage increases."
>
> The fourth commandment urged: "Work to improve production per man-hour so there will be more income to share. Have an understanding with the company that workers are to share the increased income they produce and get higher wages."

Last September John L. Lewis, who has now taken his United Mine Workers of America back into the A.F. of L., addressed a letter to every anthracite miner, in which he said:

> Every effort must be made to bring about increased production per man per day for various good reasons that affect the welfare of each and every member of the United Mine Workers of America in the anthracite region, including their wives and families.
>
> Increased production per day is largely the answer to the problem of continuity of employment and the maintenance of wage and condition standards. We must cooperate and work to the end that the present markets for anthracite coal can be maintained and enlarged if possible. Increased daily production is necessary to bring about and hold this result. Increased daily production and continuity of employment will prevent, in our judgment, the recurrence of the difficulties that we met with following World War I which resulted in the depression. Mines were shut down and the men remaining at work only were able to get two and three days' work per week. There must be no return to those conditions . . .
>
> Each individual member of the organization knows in his heart if he can increase his daily production of coal. Let each man, then, examine his own conscience in the light of these facts and act accordingly.
>
> Each individual mine worker in the anthracite industry has an obligation and a duty under these circumstances to make every contribution possible in keeping with the terms of our agreement to increase production per man per day; for the complete observance of the contract provisions; the elimination of unnecessary and illegal work stoppages and for mutual cooperation to attain the desired results.

These are doctrines which can be subscribed to without reservation by every citizen of this country. They put stress on efficiency of production, on cooperative effort, and on the principle that individual welfare depends on the general welfare. There has never been a greater need for enunciation and repetition of these principles and for universal devotion to them.

## Continued Decline in Interest Rates

In the short period since the close of the Victory Loan Drive, prices of all types of government and other high-grade bonds have risen sharply with consequent reduction in yields. Price rises of 2 to 3 points have been common in the longer maturities, and yields have shrunk by 1/8 to 1/4 of one per cent, which means that an investor buying now receives in general about one-tenth less income to call date than if he had bought on December 8.

The largest decreases in Treasury bond yields have occurred in those long-term issues not now eligible for commercial bank investment. The 22-27 year Victory Loan 2½s of 1967-72 offered in December at par have risen 3½ points, reducing the yield to 2.29 per cent, while the new 14-17 year 2¼s of 1959-62

reached 102½, to yield 2.03. Yield of the older 2¼s of 1956-59 dropped from 1.74 to 1.56 per cent, reflecting in part the fact that this issue will become eligible for bank investment in September 1946.

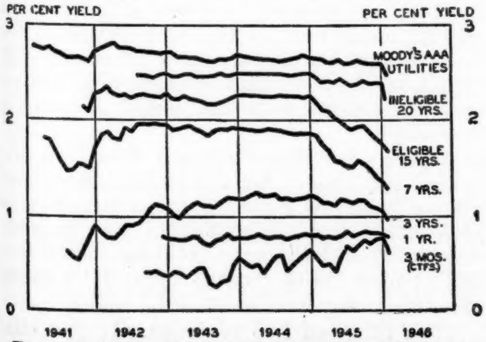
Treasury securities now eligible for bank investment were likewise strong, with the longest-term issue, the 2½s of September 1967-72, reaching almost 109 to yield slightly under 2 per cent. The decline in interest rates has reached a level at which the average commercial bank portfolio of government securities, if purchased at present market prices, would yield less than one per cent.

Accompanying the strength in governments, municipals and high-grade corporate bonds also advanced strongly.

During the drive, the belief on the part of investors that bond prices were going higher was reflected in unprecedentedly heavy subscriptions to the long-term marketable 2½s. Demand was stimulated by the continued rise in bank eligibles, which afforded non-bank holders an attractive profit on resale to banks. Repeated official expressions of approval of low interest rates and the experience of the market following previous drives encouraged heavy speculative subscriptions. The Treasury policy of consistently refunding maturing or callable bonds and notes with ⅞ per cent certificates, and the prospect for an approach to a balanced budget, ending the offering of Treasury securities for new money, induced buying on the theory that there might not be another chance to obtain government securities on a 2½ per cent basis.

Since the close of the drive, and with apparently tacit approval on the part of the authorities in the continued decline in rates, speculation and panicky buying have gained added momentum. As governments rose in price, demand spread into the highest grade municipals and corporates.

The accompanying diagram shows the decline that has taken place in interest rates during the past month and over the past year.




**Trend of Yields on U. S. Treasury Securities and High Grade Public Utility Bonds**

As the diagram shows, the largest decline in yields over the past year has been in medium and longer-term securities eligible for bank investment. For example, rates on eligibles of 15-years maturity given in the chart have fallen since the beginning of 1945 from around 2¼ per cent to less than 1¾, while eligibles of 7-years maturity have fallen during the same period from 1⅞ per cent to almost 1¼.

These declines reflect, first, the increasing tendency of banks to reach for the longer-term, higher-yielding securities, based on growing confidence in the ability and intention of the authorities to maintain low interest rates. As interest rates have declined, the pressure on banks and other investors to seek the longer maturities has increased. This, together with the policy of the Treasury in the war loan drives of restricting the supply of new medium-term securities which would later become eligible for commercial bank purchase, has accelerated the decline in rates.

Meantime, yields on the very short maturities (other than bills fixed at ⅜ of one per cent by the Federal Reserve buying and selling rates) have tended generally higher, due to the bank preference for the longer issues. The chart shows certificates averaging three months maturity.

Yields of the longer-term bank ineligible government securities declined only moderately last year, due to the continued availability of new issues in the drives, with the curve of high-grade corporate yields paralleling fairly closely that of the ineligible governments. More recently however, with the further fall in yields of bank eligibles and uncertainty as to Treasury policy with respect to new issues of 2½s, yields of both long-term ineligible governments and high-grade corporates have shown a pronounced downward tendency.

### Effects of Declining Interest Rates

The continued decline in interest rates, from levels during recent years already around all-time lows, has effects upon the national economy and the lives of millions of people too serious to be ignored. It is raising the cost of life insurance and reducing the income of savings depositors, trust beneficiaries, and religious, charitable and educational institutions. Insurance policyholders and investors are penalized both by lower yields on new investments, and by successive refinancing of old holdings at reduced rates. The problem faced by investors is highlighted by numerous cases of corporations which during the past few years have refunded 4s to 5s with bonds now yielding 2¾ per cent or less.

The steady attrition of yields tempts both institutional and individual investors to sacrifice quality in order to bolster the steadily

shrinking income. It diverts investment money into second and third-grade bonds, as well as into stocks, and into mortgage loans upon inflated appraisals, thus weakening the investment structure and storing up losses for the future.

Moreover, at a time when inflation is already rampant, the declining rates and the Treasury policy of refinancing maturing bond and note issues with short-term certificates, are adding fuel to the fire in making government securities less attractive to the public and promoting further concentration of government debt in the commercial banks, with resultant expansion of bank credit. The low rates in bonds tend to be reflected in higher capitalization of income from stocks and real estate, and to shift money that should be invested in government bonds into speculation in these markets and in commodities.

### Statements by Federal Reserve Officials

That Federal Reserve officials are concerned over these developments is evidenced by some strongly-worded statements. On January 17, Chairman Eccles of the Board of Governors of the Federal Reserve System, in connection with the announcement of the increase in margin requirements on stock exchange collateral from 75 to 100 per cent, warned that:

> . . . So long as the public debt continues to be monetized through the purchase of government securities by the banking system, the supply of money will continue to increase, thus tending further to reduce the interest rate on savings and investment funds. The resultant pressure of an increasing money supply and of lower interest rates is bound to have a further inflationary effect upon all capital assets and to increase the difficulty of holding down the cost of living.
>
> It is, therefore, imperative that the process of further monetizing of the public debt through the banking system be ended so that the rate of return on investments would be stabilized and would reflect the supply of savings and investment funds in relation to the demand instead of reflecting an increasing amount of bank credit. This process needs to be stopped not only by bringing about a balanced budget, but also through measures to check further unnecessary expansion of commercial bank holdings of government securities.

A few days later Allan Sproul, President of the Federal Reserve Bank of New York, in an address before the New York State Bankers Association, after reviewing the monetary and credit policies pursued during the war, pointed out that the Victory Loan drive brought to an end the war financing program and gave an opportunity to resurvey these policies. Referring to the abundant supply of money and liquid assets in the hands of the public, the restricted supply of goods and services, and the favorable business outlook for the next few years, he said:

> . . . As gilt-edged securities, both public and private, rise in price under pressure of the abundant money supply, funds flow over increasingly into lower grade securities and into equities, and into commodity, real estate and other markets, under the pressure of rising expectation of profits and the apparent minimizing of risks. The stage was never better set for another demonstration of this character.
>
> To promote an inflationary boom at this time would be a poor prologue for the maintenance of full production and high employment in the post-transition period. I do not suggest that monetary controls can cope single-handed with the inflationary aspects of the present situation, nor even that they can be used so vigorously as to constitute a major anti-inflation weapon. At the moment the development of a wage-price spiral seems our greatest danger, and monetary action is not the answer. But we must devise a monetary and credit policy which, taking due account of the appropriate requirements of the management of the public debt, will discharge our responsibility for promoting economic stability, and support the measures taken by other agencies to curb inflationary tendencies, in the present temporary circumstances.

Still a third statement bearing upon present credit tendencies was that issued the end of January by John J. McKee, concluding a ten-year term as member of the Board of Governors of the Federal Reserve System, in which he expressed the view that reducing further the interest rates on government securities would impair the financial health of the nation's banks. Speaking particularly about smaller banks, he said:

> Nothing would appear to be more shortsighted than the proposals which we hear from time to time for reducing interest rates below present abnormally low levels . . . We made a serious mistake in the Nineteen Twenties in ignoring the spread of difficulties among our country and small city banks. Let us not repeat the same mistake in the next decade.

These statements by high central banking officials who are charged with responsibility for the formulation of credit policy are of foremost importance, and will be weighed carefully by the money market and business generally.

## The Federal Budget, 1946 and 1947

President Truman's budgets for the fiscal years 1946 and 1947, submitted to Congress last month, reflect the sweeping changes now taking place in federal finances as a result of the country's adjustment from war to peace. The budget message was awaited with keen interest and anxiety as revealing the first official indications as to the progress of the Government in cutting back from the $100 billion level of wartime expenditures and regaining control over the public finances in peacetime.

**A year ago when President Roosevelt presented the budget for the current fiscal year ending June 30 next on the assumption of continuing war, he estimated war expenditures of $69.4 billion and total expenditures at $82.5 billion. With receipts set at $41.3 billion, the deficit was forecast at $41.3 billion.**

**Then followed two revisions, the first after the ending of the German war in May and the**

second following the Japanese collapse in August. The third revision for 1946, just issued accompanying the 1947 budget, estimates war expenditures at $48.8 billion and total expenditures $67.4 billion, with receipts $38.6 billion, and a deficit of $28.8 billion.

Continuing the transition in public finances from a wartime to a peacetime basis, the first estimates for fiscal 1947 just presented by President Truman contemplate a fall in war expenditures to $16 billion and in total expenditures to $35.1 billion. With receipts estimated at $31.5 billion, the expected deficit is cut to $3.6 billion.

In other words, if current expectations are realized, there will be a reduction of $50 billion in the deficit since the fiscal year 1945 and an approach to a balanced budget in the second fiscal year following the wartime peak. Moreover, the totals for 1947 include some $3 billion of expenditures requested by the President but not yet authorized by Congress, without which the estimated deficit would be but $1 billion.

A long-term summary of budget receipts and expenditures, as well as public debt, is given in the accompanying table for purposes of comparison. This does not include extra-budgetary net expenditures of government corporations, estimated at $800 million in fiscal 1947.

**United States Government Receipts and Expenditures 1914-1947**
**(In Millions of Dollars)**

| Year Ended June 30 | Total Net Receipts | Net Expenditures: National Defense | Net Expenditures: All Other | Net Expenditures: Net Total | Net Surplus or Deficit |
|---|---|---|---|---|---|
| 1914 | $ 735 | $ 263 | $ 472 | $ 735 | $ ... |
| 1915 | 698 | 268 | 493 | 761 | —63 |
| 1916 | 783 | 286 | 448 | 734 | +48 |
| 1917 | 1,124 | 1,452 | 526 | 1,978 | — 853 |
| 1918 | 3,665 | 10,838 | 1,859 | 12,697 | — 9,033 |
| 1919 | 5,152 | 14,444 | 4,071 | 18,515 | —13,363 |
| 1920 | 6,995 | 2,718 | 3,685 | 6,403 | + 292 |
| 1921 | 5,625 | 1,767 | 3,349 | 5,116 | + 509 |
| 1922 | 4,109 | 888 | 2,485 | 3,373 | + 736 |
| 1923 | 4,007 | 675 | 2,620 | 3,295 | + 712 |
| 1924 | 4,012 | 603 | 2,446 | 3,049 | + 963 |
| 1925 | 3,780 | 626 | 2,437 | 3,063 | + 717 |
| 1926 | 3,963 | 599 | 2,499 | 3,098 | + 865 |
| 1927 | 4,129 | 614 | 2,360 | 2,974 | + 1,155 |
| 1928 | 4,042 | 643 | 2,460 | 3,103 | + 939 |
| 1929 | 4,033 | 698 | 2,601 | 3,299 | + 734 |
| 1930 | 4,178 | 721 | 2,719 | 3,440 | + 738 |
| 1931 | 3,190 | 667 | 3,004 | 3,652 | — 462 |
| 1932 | 2,006 | 664 | 3,871 | 4,535 | — 2,529 |
| 1933 | 2,080 | 651 | 3,213 | 3,864 | — 1,784 |
| 1934 | 3,116 | 578 | 5,433 | 6,011 | — 2,895 |
| 1935 | 3,800 | 726 | 6,284 | 7,010 | — 3,210 |
| 1936 | 4,116 | 940 | 7,726 | 8,666 | — 4,550 |
| 1937 | 5,029 | 967 | 7,210 | 8,177 | — 3,148 |
| 1938 | 5,855 | 1,066 | 6,173 | 7,239 | — 1,384 |
| 1939 | 5,165 | 1,251 | 7,456 | 8,707 | — 3,542 |
| 1940 | 5,387 | 1,711 | 7,287 | 8,998 | — 3,611 |
| 1941 | 7,607 | 6,301 | 6,409 | 12,711 | — 5,103 |
| 1942 | 12,799 | 26,011 | 6,385 | 32,397 | —19,597 |
| 1943 | 22,282 | 72,109 | 6,070 | 78,179 | —55,897 |
| 1944 | 44,149 | 87,039 | 6,705 | 93,744 | —49,595 |
| 1945 | 46,457 | 90,029 | 10,376 | 100,405 | —53,948 |
| 1946‡ | 38,609 | 48,800 | 18,594 | 67,394 | —28,785 |
| 1947† | 31,513 | 16,000 | 19,125 | 35,125 | — 3,612 |

**United States Government Public Debt. 1914-1947**
**(In Millions of Dollars)**

| June 30 | Total | June 30 | Total | June 30 | Total |
|---|---|---|---|---|---|
| 1914 | $ 1,188 | 1925 | 20,516 | 1936 | 33,778 |
| 1915 | 1,191 | 1926 | 19,643 | 1937 | 36,425 |
| 1916 | 1,225 | 1927 | 18,510 | 1938 | 37,165 |
| 1917 | 2,976 | 1928 | 17,604 | 1939 | 40,440 |
| 1918 | 12,244 | 1929 | 16,931 | 1940 | 42,968 |
| 1919 | 25,482 | 1930 | 16,185 | 1941 | 48,961 |
| 1920 | 24,298 | 1931 | 16,801 | 1942 | 72,422 |
| 1921 | 23,976 | 1932 | 19,487 | 1943 | 136,696 |
| 1922 | 22,964 | 1933 | 22,539 | 1944 | 201,003 |
| 1923 | 22,350 | 1934 | 27,053 | 1945 | 258,682 |
| 1924 | 21,251 | 1935 | 28,701 | 1946‡ | 275,000 |
| | | | | 1947† | 271,000 |

**Source: Compiled from President's Budget Messages and Annual Reports of the Secretary of the Treasury. Expenditures exclude net appropriations to old-age insurance trust funds, while corresponding social security taxes are excluded from net receipts. Expenditures exclude sinking fund for debt retirement. National defense total excludes expenditures charged to War Department for rivers and harbors, and flood control; also for Panama Canal; but include loans to foreign governments in 1917-21 and lease-lend in 1941-47. †Budget estimate. ‡Revised budget estimate. Above figures do not include government agency net expenditures or guaranteed debt.**

### Expected Decline in Public Debt

Notwithstanding the indicated deficit for fiscal 1947, there will be for the first time in seventeen years no increase in the total federal debt, which has risen during that period from $16 billion to $278 billion at the present time. In fact, the President estimates a debt decrease of $3 billion during the balance of this fiscal year and an additional $4 billion in fiscal 1947. This will be possible both because of the reduced deficits and because of using the $25 billion Treasury cash balance built up during the Victory Loan, which is to be drawn down by the end of fiscal 1947 to the prewar level of $3 billion.

From the long-range standpoint, of course, this debt reduction is illusory and not the same as would occur from the Government living within its means and having a surplus of revenue receipts over expenditures. The Government is in a position similar to that of an individual who, having borrowed more than he needs, uses his excess cash to pay down a like amount of obligations.

### Need for Budget Scrutiny

The large decrease in expenditures and in deficit is gratifying and good as far as it goes, but affords no grounds for complacency in view of anticipated expenditures running at the rate of $35 billion annually. This is still a monumental sum, and calls for careful scrutiny of the various budget items to determine how far all possible economies have been effected. With the ending of the war there was bound to be an automatic curtailment of expenditures, but much more than this will be necessary to bring budget costs down to levels within the capacity of the country to carry and to provide for debt retirement without

serious detriment to the people's standard of living.

Looking back over the trend after World War I, it will be found that expenditures, which reached their peak in the Armistice quarter of 1918, declined rapidly to 25 per cent of that peak within one year. During the same period the budget was brought into balance, and in the final quarter of calendar 1919 there was a surplus of receipts over expenditures.

In the case of World War II, expenditures reached a peak in the June 1945 quarter and declined in the September and December quarters at about the same rate as after World War I. Were this pattern continued, expenditures for fiscal 1947 would be down to around $27 billion, instead of the $35 billion forecast in the budget. On this basis, the estimated receipts of $31 billion for 1947 would yield an actual surplus of income, which could be used either for a real beginning on the program of debt retirement or for further reduction of taxes now weighing heavily upon individuals and business.

The following table shows the principal groupings of expenditures as forecast in the 1946 and 1947 budgets, compared with 1945 and the prewar year 1939:

**U. S. Government Expenditures**
**Fiscal Years Ended June 30**
**(In Billions of Dollars)**

| | 1939 | 1945 | Est. 1946 | Est. 1947 |
|---|---|---|---|---|
| War activities | $1.3 | $90.0 | $48.8 | $16.0 |
| Interest on public debt | 0.9 | 3.6 | 4.7 | 5.0 |
| Veterans' pensions & benefits | 0.5 | 2.0 | 3.3 | 4.2 |
| Aids to agriculture | 1.0 | 0.6 | 0.5 | 0.5 |
| Relief | 3.0 | .... | .... | .... |
| Social security, retirement | 0.5 | 1.0 | 1.2 | 1.0 |
| Public Works Program | 0.5 | 0.3 | 0.7 | 1.1 |
| General Government | 0.9 | 1.1 | 1.3 | 1.6 |
| Tax refunds | 0.1 | 1.7 | 2.7 | 1.6 |
| International finance | .... | .... | 2.5 | 1.7 |
| Supplemental & proposed | —0.1 | .... | 1.6 | 2.4 |
| Total expenditures | $8.7 | $100.4 | $67.4 | $35.1 |

See footnotes to summary on preceding page.

In examining this condensed summary, the reader is cautioned against taking too literally the expenditures shown under the individual headings, since in many cases additional expenditures for similar purposes are included under other headings or under "Supplemental and proposed". This makes for confusion and difficulty in comparison, and emphasizes further the need for thoroughgoing analysis of the figures by Congressional committees and by outside qualified students.

It will be seen that of the expenditures estimated for 1947 the largest item, comprising nearly half the total, is for national defense, amounting to $16 billion (before allowance for an estimated $1 billion net receipts of government corporations). This, as the President says, "is a large sum for a year which begins ten months after the fighting has ceased."

Obviously, it is not possible for the layman, with the limited information available, to pass judgment upon this figure. Certainly economy ought not be carried to the point of impeding the military establishment either in the efficient conduct of present operations or in the development of adequate programs for future defense. Apart, however, from the possibility that the military departments may not be immune to the general bureaucratic reluctance to trim unnecessary spending, it is to be noted that the item "national defense" in the budget covers a good deal of territory.

Of the total listed under this heading, approximately a third represents expenditures for procurement and construction, $5 billion for pay, subsistence, travel, and miscellaneous costs of the armed forces, $500 million for mustering-out pay, and $1.5 billion for contract settlement. In addition, the defense budget includes large items for other government departments including Treasury and Agriculture, and foreign relief in occupied areas, as well as for such agencies as the U. S. Maritime Commission, War Shipping Administration, Office of Price Administration, and United Nations Relief and Rehabilitation Administration. The President indicates that many of these estimates are tentative at this time and that a detailed supplemental budget of war expenditures will be submitted in the Spring. The magnitude of these totals and their diverse character — some of them not ordinarily thought of as part of military costs — call for careful probing.

### Growth of Non-defense Costs

The most disquieting feature of the budget is the rapid rise of costs other than those listed under national defense. These were put at $19 billion for 1947, as against $7.5 billion in 1939 and an average of $2.6 billion in the decade 1921-30 after World War I. Of the 1947 total, the two principal items are $5 billion for interest on the public debt, equal almost to total revenue receipts in 1939, and veterans' pensions and benefits of over $4 billion.

The $500 million shown for "aids to agriculture" covers only part of the total cost of the broad program of agricultural subsidy and farm price support, estimated at more than $2 billion, the balance being under "supplemental and proposed" or other headings. Likewise, the budget shows $1.1 billion for public works, or twice the amount budgeted in 1939, a year of substantial unemployment, and even this total does not cover the full amount, which the President says is estimated at $1.7 billion.

Although the ending of the war might ordinarily be expected to bring curtailment of government departmental employment and expenditures, the President finds that expenses

for general government for fiscal 1947 "are expected to continue the slowly rising trend which began in 1943."

Finally, the President points out that many of the estimates for new programs recommended in his message are only initial year figures, subject to increase when and if such legislation is enacted or becomes fully effective. This is true both of programs for domestic legislation and for international finance and reconstruction, such as the Bretton Woods Stabilization Fund and International Bank, the Export-Import Bank, and other foreign lending, including the British credit.

The message contains recommendations for increased expenditures for rural electrification and river valley power development, a national research aid program, government guarantee of "full employment", a materials stockpiling program, federal aid for airport construction, federal aid for school lunches ($50 million in 1947), "substantially" increased unemployment relief benefits for veterans and non-veterans, higher federal salaries, a comprehensive national health and medical care program, St. Lawrence Waterway Development, and other projects.

The President acknowledges that no allowance has been made in the budget for the cost of major elements of the proposed national health program, on the grounds that the greater part of such costs would be covered by trust funds; but this would call for an increase in payroll taxes. It is not always clear how much allowance has been made in the budget for other elements of his broad program. No one knows what legislation to maintain "full employment" would cost.

### How Much Real Economy?

All this raises a question as to just how serious has been the search for ways of reducing expenditures, and whether this is not another budget reflecting the same liberal spending philosophy as in the 1930s, when the objective was to "increase purchasing power" and to accomplish social reforms.

Once again there is being demonstrated the difficulty of shrinking down the size, multiplicity, and cost of the government establishment once it has been permitted to expand out of normal proportions. Each new department or bureau, as well as existing ones which have grown, tends to regard its work as essential, and resists efforts to discontinue or curtail its activities. Moreover, government spending tends, at the expense of all taxpayers, to benefit particular groups and communities, thereby building up vested interest in the continuance of spending. Even among conservative people who in general oppose the principle of leaning on government, the unanimity has often broken down when spending projects for specific industries and localities are involved.

With the budget at its present dimensions, and with so many channels through which money is poured out, the amount of waste becomes tremendous. The following excerpt from a piece by Robert C. Ruark, special writer for the New York World-Telegram (January 30), is merely one illustration of the leakages that occur when so much money is available for spending in so many directions:

> "I get $300 worth of mustering-out pay," one young man, who was once a WPA playwright, a USO actor and who is an authority on Shakespeare, explains. "At $100 a month, that keeps me for three months. Then I show up and register at USES as a writer.
>
> "All I have to do is show a manuscript to prove I am a writer and I am on unemployment relief. Under the GI bill, I'm entitled to 52 weeks at $20 a week if I can't get a job. Okay, I can't get a job. Who wants to hire a playwright?
>
> "That takes care of me for a year. At the end of that time I will investigate the educational aspects of the bill. I'm entitled to four years of education at $65 a month."

The difficulty of contracting public spending — even in times of active business — is the weakness in the theory of "compensatory government spending" to smooth out fluctuations in the business cycle. Under any system of budgetary practice, now is the time when the Government ought to be curtailing its activities and not adding unnecessarily to the stream of purchasing power through its own expenditures when manpower and materials are scarce.

The President speaks repeatedly in his message of the danger of inflation and at one point declares flatly that "our chief worry is still inflation". He points out that "it is good to move toward a balanced budget and a start on the retirement of debt when demand for goods is strong and the business outlook is good." "These conditions," he says, "are with us to-day." With the national income as high as now expected, this is the time if ever when we ought to be balancing the budget, lowering tax rates, and amortizing the public debt.

### The Longer-Range Prospect

The most discouraging feature from the long-range standpoint, and one which strengthens the impression that no real economy is intended except in the obvious war categories, is the President's statement that, "expenditures can hardly be expected to be reduced to less than $25 billion in subsequent years." This, if true, would mean a minimum level of federal costs approximately six times the total revenue receipts in 1939, one of the highest peacetime years. With state and local government expenditures of some $10 billion annually, the total peacetime bill for government would run to $35 billion or more a year.

As against the President's projection of total federal costs, may be cited the careful study* of the postwar tax problem published last Fall by a group of leading fiscal and tax experts comprising the Committee on Postwar Tax Policy, in which it was brought out that a federal budget of $22 billion (the maximum presented in their calculations) would be too high to allow for the tax relief needed to afford freedom for enterprise, except on very optimistic assumptions as to national income. Even at $140 billion of national income, a budget of $22 billion would, the Committee declared, involve serious strain on the taxable resources.

This conclusion appears to be borne out by the President's budget message, which holds forth little hope of further tax reduction. He points out that if extraordinary receipts from the disposal of surplus property and renegotiation of contracts be disregarded and if the tax reductions adopted in the Revenue Act of 1945 were fully effective, present tax yields would be at the rate of not $31.5 billion but $27 billion, or only $2 billion over the anticipated minimum level of peacetime expenditures. Considering that these estimates are based, as the President says, on a good business outlook, they leave totally inadequate margin for tax reduction or debt retirement.

It is true that the President envisions eventual attainment of a still higher level of national income based on the "full employment and high productivity that we hope to achieve," from which the "present tax system" might be expected "in future years" to garner more than $30 billion of revenue. But this is all very vague and indefinite, and can hardly be counted on as a basis for sound budget making at the present time.

In concluding this discussion of the federal finances, it may not be out of place to refer to the recent directive from General MacArthur's Headquarters outlining for the Japanese a stern regime of monetary and fiscal rectitude, including the cutting of government expenses to the minimum and the cessation of deficit financing through sale of government securities to the commercial banks and the Bank of Japan. The suggestion inevitably arises as to whether it might not be a good idea for us to take ourselves a little of the medicine that we are prescribing for others.

## State and Municipal Finances

In contrast with the fiscal problems facing the Federal Government is the financial condition of the states and municipalities. With tax receipts reflecting peak employment at high wages, as well as full occupancy of housing and business building space, state and municipal finances generally have been put on the strongest basis in decades. Practically every tax except those applied to rationed commodities yielded an abundant harvest of income throughout the war.

States have reaped the greatest benefits, with declines in such sources as gasoline, liquor, and cigarette taxes more than offset by the sharp increase in nearly all other revenues. For example, Nebraska, Oregon and New Hampshire, three states whose highway revenues accounted for over half of their income in 1942, ended the war with no operating difficulties and treasuries well supplied with cash. In the aggregate, the present cash surpluses of all state governments combined are estimated at $3 billion, actually exceeding their gross indebtedness by $575 million.

The only weakness that developed was in the obligations of highway toll authorities which depended heavily on pleasure traffic. In these, however, the delays on interest payments were so few in relation to the outstanding indebtedness of such projects that their record was far better than the dire predictions heard in the early stages of the war.

During the war, despite the heavy call of federal loans on investment funds, the market for state and municipal financing remained surprisingly favorable. Except for one sharp reaction early in 1942 occasioned by the possibility that the Government would attempt to end their tax exemption, municipal bonds have risen almost steadily in price. According to the index of "The Daily Bond Buyer" on twenty bonds, municipal prices touched an all-time prewar peak in November 1941, of a 1.90 per cent basis, then reacted to 2.51 in March 1942, from which time the trend was almost consistently upward to a wartime peak of 1.35 in May 1945. V-J day brought a reaction to 1.72 but from October 1945, prices recovered at first slowly and then sharply to new all-time peaks. On January 24, 1946, the index stood at 1.32 per cent. The amazingly cheap cost of borrowing is illustrated by the following recent issues on which the net interest cost to the borrower was less than one per cent:

| | Life of Loan | Interest Rate | Net Interest Cost |
|---|---|---|---|
| $3,000,000 Allentown, Pa. School District due 1948-74 | 2-28 years | 1% | .94% |
| 1,820,000 Massachusetts Sinking Fund Refinancing, due 1970, callable in five years or thereafter | 24 years | 1% | .76 |
| 1,750,000 Nashville, Tennessee due 1950-74 | 4-28 years | 1% & ¾% | .979 |

*A Tax Program for a Solvent America; The Ronald Press, New York, 1945.

### State and Local Debt

The Bureau of the Census has estimated that on June 30, 1945, the gross debt of the states and local governmental units stood at $16.5 billion, a reduction of $874 million from the previous year and $3.7 billion or 18.3 per cent from a $20.2 billion high point in 1940. In dollar reductions states have contributed about 30 per cent and municipalities the remainder, but in percentages of decline the states have shown about twice the progress of municipalities.

In commenting on state indebtedness, the Bureau of the Census points out that short-term debt which in 1940 totalled $315 million has now dwindled to approximately $25 million.

### Post-War Financing

In dollar amounts the capital programs of states and municipalities appear less defined now than they were a year ago. At that time, with the growing hope for an early end of the war, there was a general rush to plan, so that states and municipalities could help to cushion the unemployment crisis so widely predicted at the conclusion of hostilities. There were hopes then for generous assistance from the Federal Government, so the stage was perfectly set for ambitious planning. Since V-J day, developments have had a sobering influence. Instead of unemployment, labor remains scarce. Materials are difficult to obtain and, above all, the cost factor was not appreciated when plans and blueprints were taking form. In many instances it has been impossible to obtain contract estimates, so until matters clear, it is doubtful that states and municipalities will proceed with any great volume of financing.

Opinions on the timing vary, but Carl H. Chatters, Executive Director of the Municipal Finance Officers Association of the United States and Canada, expressed the following thoughts in an address before the Municipal Forum of New York on November 29, 1945. He emphasized that in view of the many variable factors which exist these were only opinions.

> . . . there will be no appreciable volume of new issues between now . . . and the Summer or Fall of 1946. Beginning somewhere about that time and continuing for approximately a year, there ought to begin to be some increase in volume, until at the Fall of 1947 or about that period, the volume of new bonds will begin to approach the pre-war volume. After that date it is more probable than not that there will be a more substantial increase, that is, beginning approximately a year and a half from now . . .

### State Programs

In an attempt to learn what progress had been made, each state has been canvassed within the last month on three general questions.

1. The estimated capital program over the next five years.
2. How it will be financed, i.e., from cash on hand, grants-in-aid, or through bond issues; and
3. If through bonds, what portion may be sold within two years.

Replies are not yet complete but the answers from over half the states establish a fairly definite pattern. Several explained that specific information must await the final approval of legislatures now in session or yet to meet. Many complained of the shortage of labor and materials, and others mentioned the high cost of construction.

A summary of the replies shows how strong is the financial position of state governments in relation to their planning. More specifically, the capital programs of 26 states total $2,394 million, of which the large amount of $2,018 million or 84 per cent is to be met on a pay-as-you-go basis from cash already accumulated or anticipated by the end of the construction period. It is significant that federal aid is estimated at $262 million or 11 per cent and that bond financing at $113.7 million will play the very small role of 5 per cent.

New York intends to finance its billion dollar program from its $400 million cash accumulation plus $400 million from future income and $200 million federal aid. Pennsylvania will add the proceeds of a $50 million bond issue, the only sizeable financing authorized, to its $376 million cash and anticipated revenues. Fourteen of the twenty-six states report that their programs are fully covered by cash or anticipated revenues, and only in three is cash less than 50 per cent of the proposed program. Anticipated revenues usually represent surpluses of gasoline and other taxes that are expected to accumulate before the completion of the program. Indeed, state governments are to be commended on their forethought in husbanding the large amounts of cash which were accumulated during the war period.

The prospective dearth of state bond issues may change through two main sources, namely soldiers' bonuses and public housing issues. Already three states, Massachusetts, New Hampshire, and Vermont, have approved bonuses ranging from $100 to $120, and legislative proposals are quickening in others such as Illinois, Rhode Island, Texas, New Jersey and Minnesota where provisions run from $200 to a maximum of $750. If the average level should approximate $300, simple multiplication by the number of men in the armed services would produce a figure of over $3 billions if the electors are so disposed. Vast federal, state and municipal housing developments are being widely discussed and when to these are added the construction programs of counties and municipalities, the supply of new tax-exempt issues could turn from their present trickle to an impressive volume in the years immediately ahead.

*Painting by Rockwell Kent—"Lightering Nitrate in Chile"*

## Chile Uses Nitrate to "Buy American"

CHILE is often called "The Land of Contrasts." It extends for 2,600 miles from the tropics to the subarctic and is nowhere as much as two hundred and fifty miles wide.

The country has the largest commercial deposits of sodium nitrate in the world. As an exporter of copper, Chile ranks first in the world, and as a producer is second only to the United States. Chile is also the chief Latin-American coal-producing country, and its valuable iron ore is shipped almost exclusively to the United States.

Manufacturing is developing rapidly—food processing and textiles being the leaders. The value of Chilean foreign trade is one of the highest in Latin-America; per capita exports being about as high as those of the U. S.

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